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C O N F I D E N T I A L SAN SALVADOR 00128

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TGS: EPET, ENRG, PGOV, PREL, ES
SUBJECT: FMLN TAP PETROCARIBE

REF: A. 07 SAN SALVADOR 2300

¶B. 06 SAN SALVADOR 2250

Classified By: Charge Mchael Butler for reasons 1.4(b) and (d)

¶1. (SBU SUMMARY: As part of a so-called pilot project, six FMLN mayors began in December to import Venezuelan diesel through Nicaragua for distribution at below market prices. The joint venture with Venezuela's PDVSA is currently importing small volumes of diesel, but intends to break ground in February on a 300,000 barrel oil depot in the Salvadoran port of Acajutla. Although the volume of current imports is small, other importers have complained about unfair competition and warn that the group may convince another company to import larger volumes. In addition to public relations benefits, the efforts will likely provide campaign funds for the FMLN and make them more beholden to Venezuela. Though clearly concerned, the GOES is reluctant to take any action to make it appear that the FMLN is a victim of ruling party retribution or that ARENA is responsible for cutting off cheap fuel. END SUMMARY.

MODEST PROJECTED IMPORTS SURPASSED RIGHT AWAY

¶2. (SBU) According to industry sources and press reports, a group of mayors from the leftist Frente Farabundo Marti para la Liberacion (FMLN) began in December a "pilot plan" to distribute discounted Venezuelan diesel through six independent "white flag" service stations. After an initial plan to import 75,000 gallons per month, the joint venture company, Albapetroleo, later reported increased imports of more than 300,000 gallons over a three-week period. It is reportedly using nine tanker trucks to import up to 500,000 gallons of diesel per month from Nicaragua, roughly 3% of El Salvador's diesel market. Supposedly, Albapetroleo will benefit from low-interest long-term financing for 40% of fuel costs offered under the Petrocaribe initiative with a 1% interest rate over a 23-year repayment period and a 2 year grace period.

¶3. (U) The venture began during a March 2006 visit to Venezuela. The group of FMLN mayors signed an agreement to import Venezuelan fuel under the Petrocaribe Initiative. The group created the Asociacon Intermunicipal de Energia para El Salvador (ENEPASA) which formed a company, Albapetroleo, as a joint venture with Petroleos de Venezuela, SA (PDVSA). PDVSA owns 60% of this company while ENEPASA contributed the remaining 40% of capital using public funds from the Fondos para el Desarrollo Economico y Social de los Municipios (FODES). While some mayors criticized this use of development funds for a private sector project, FMLN presidential candidate Mauricio Funes defended the project, emphasizing its benefits to consumers.

OIL COMPANIES PROTEST DUMPING

¶4. (SBU) Competing oil importers and distributors have complained that Albapetroleo is distributing fuel at a loss, at prices up to 30 cents per gallon lower than competitors. The Ministry of Economy (MINEC) estimates Albapetroleo is selling diesel at a wholesale pre-tax price of $2.54, roughly equivalent to international market prices excluding transportation and operating costs, which Esso's country manager estimated at 25 cents per gallon. Managers of two competing importers told econoffs they can't match these prices without losing money. If, as reported, Albapetroleo receives Petrocaribe loans for 40% of the fuel costs (roughly $1.00 per gallon at an FOB price near $2.50 per gallon) and offers a discount of 25 cents per gallon, the remaining 75 cents per gallon would be available for social projects and other purposes. FMLN Presidential candidate Mauricio Funes previously told Embassy officials that the FMLN would use fuel proceeds to finance the FMLN election campaign; other party officials have separately suggested the funds would be used for party social projects, but not for the campaign.

NEW FUEL DEPOT TAKES TIME TO BUILD

¶5. (SBU) Albapetroleo revealed on January 28 that it plans to begin construction of its own fuel depot in Acajutla on February 2. GOES and industry sources estimate the depot will take 12-15 months to build, but other industry sources have suggested that part of the depot could be operational within 8 months. A former ExxonMobil manager who worked as a consultant for the depot project described it as "state of the art" with careful safety standards. The first phase will install two 50,000 barrel tanks and the second phase will add another 50,000 barrel tank, two 20,000 barrel tanks, two LPG spheres and one storage tank for turbo fuel. Four dedicated pipelines will allow the facility to offload different types of fuel from offshore buoys.

OTHER OPTIONS

¶6. (C) Minister of Economy Yolanda de Gavidia discounted the possibility that the oil depot could be completed before the 2009 elections. De Gavidia told Econoffs that without a depot in El Salvador, the volume of Albapetroleo's fuel imports would remain too small to have a major impact on the market. She added that Albapetroleo could find an existing importer willing to import larger volumes. She noted that Puma, an affiliate of Netherlands-based Trafigura, aborted an earlier plan to import Venezuelan fuel for distribution through Albapetroleo (reftel B).

¶7. (C) Former Puma general manager Alejandro Alle told econoff that concerns expressed by the GOES helped to block a previous plan to import discounted Venezuelan fuel through Puma's existing 220,000 barrel fuel depot in Acajutla. After PDVSA approached Trafigura management in London in 2006 to offer discounted fuel, Alle said he helped to postpone the plans. He eventually resigned from PUMA in May 2007 due in part to Trafigura's continuing interest in the Venezuelan proposal.

¶8. (C) Current Puma manager Renan Gonzalez told econoffs January 23 that Puma does not plan to help Albapetroleo, but he suggested that Cenergica, an importer of fuel oil for electricity generation, might be tempted to work with them. He reported that Trafigura will discuss how to confront the competition from Albapetroleo during a regional meeting in late January. Gonzalez noted that Puma is most vulnerable to competition from Albapetroleo, but warned that other importers (Esso, Texaco and Shell) will also be affected. He said that some independent stations are pressuring for lower prices and threatening to terminate their contracts with Puma if it cannot meet Albapetroleo's prices. Puma is the main supplier to independent service stations being poached by

Albapetroleo and it relies on diesel for 70% of its revenue.

GOES WILL NOT CUT OFF ALBAPETROLEO

¶9. (U) When questioned by the press about the matter, President Saca remarked that if Albapetroleo offers cheaper fuel, "how good for competition!" He later noted that debts incurred under Petrocaribe would need to be repaid and suggested that other distributors could use appropriate institutions to air their complaints.

¶10. (C) Minister de Gavidia called Econ Counselor to discuss the matter, clearly concerned over the negative impact of Albapetroleo's imports. Econ Counselor asked whether a dumping case might be brought against Albapetroleo, given the below market price of the imported diesel. She responded that any GOES intervention to limit these imports could make the FMLN look like a "victim". She asked Econ Counselor to "talk to the oil companies" about filing a possible anti-competition case against Albapetroleo. Econ Counselor noted that relations between Exxon, Shell and the Superintendent of Competition were not the best, given the Superintendent's recent anti-trust cases filed against them (reftel B). However, in econoffs' subsequent conversation with Puma's Gonzalez, he said that the possibility of presenting an anti-competition complaint would be one of the matters discussed in their upcoming regional meeting.

COMMENT

¶11. (C) The media has given the FMLN and, by extension, Venezuela very positive press coverage on the cheap diesel being offered. At least one station was photographed displaying a Venezuelan flag while distributing the fuel. It is unclear whether Albapetroleo will be able to maintain and increase supplies over an extended period. However, the fact that they are moving forward with their fuel depot construction is an indication of their intent to do so. Salvadoran municipal and legislative elections are now less

than a year away and the presidential election about 14 months away. Both events are within the 12-15 months needed to complete the fuel depot, even if an alternative source cannot be found. Thus, the FMLN could get an even greater public relations story around the time of the elections.

12 (C) Even though the market is being distorted, the GOES will not act against Albapetroleo for fear of being perceived as against low fuel prices. We do not think that the private companies, especially Exxon and Shell, will act right away for similar reasons; and, in the larger companies' cases, because they are suffering less than Puma at this point. According to our sources, Albapetroleo is following import, fiscal and quality rules when it brings in the diesel, which leaves out other regulatory action. The Superintendent of Competition could initiate its own case but, given the apparent consumer benefits and President Saca's statements in favor of the imports, that too appears unlikely. Although FMLN will likely be criticized for using Petrocaribe credit for political purposes, there appear to be no legal restrictions on using these funds for political campaigns.
BUTLER